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5 January 1954

MEMORANDUM FOR: Assistant Comptroller

SUBJECT : Liquidation of Overpayment of Terminal Leave - Staff Agent [redacted]
25X1

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1. Reference requests concurrence in the content of a proposed dispatch, No. [redacted], advising as to the method of collection of the subject overpayment. You have asked that if we find legal objection to the recommended procedure for collection, we furnish our opinion and advise with respect to three specific points which constitute the legal questions raised by the proposed dispatch.

2. We concur in paragraph 1 of the proposed dispatch. A system of periodic payments would seem to be the only logical solution to collection of a considerable sum which the employee was financially unable to liquidate immediately. We assume that you are satisfied that the terms of repayment are the optimum from the Agency standpoint and that process of collection will not be unnecessarily protracted.

3. We are unable to concur in the remaining portions of the proposed dispatch and therefore will address ourselves to the second and third questions raised in paragraph 2 of the reference.

4. There is no authority under existing Federal income tax law and regulations for a cash-basis taxpayer to report on his return net salary in any year in which he has repaid an excess of salary received under claim of right in a prior year. The taxpayer compelled to refund overpayments previously received in such manner finds himself in a legal dilemma inasmuch as he is precluded from reopening his prior year's return, because repayment is not made until a subsequent year, and at the same time is allowed to recoup a tax benefit from repayment only by an itemized miscellaneous deduction in the year in which repaid, thereby precluding use of the standard deduction which he might otherwise employ. The fundamental rule from which this seeming inequity results is grounded upon a decision of the U. S. Supreme Court in North American Oil Company v. Burnet, 286 US 417, 3 USTC paragraph 943 (1932).

5. As is apparent, the only exception to the rule is limited to cases of receipt based upon absence of any claim of right. Although there is a dearth of case law on this point, we are informally advised

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by officials of the Internal Revenue Service that absence of claim of right can be found only in those situations where the taxpayer at the time of receipt is aware that he has received an excessive payment and consequently realizes the restrictions upon its disposition. Inasmuch as the effect of the procedure, which you indicate is presently followed, may be to afford an unwarranted tax benefit to certain employees under circumstances that are not directly related to the peculiar functions of this Agency, we do not believe that it can be given blanket legal sanction except where recognition is obtained from the Internal Revenue Service of particular circumstances unique to CIA which justify non-application of the strict claim of right test. To this end we have informally mentioned the existence of the problem to cleared officials in IRS and furnished them hypothetical illustrations of various ways in which difficulty may arise. These officials evidenced full appreciation of the nature of the problem and wished to give it more complete consideration before indicating the extent to which they felt our circumstances fell without the claim of right rule. We will inform you as soon as we have heard further from them.

6. We are of the opinion that the language of paragraph 3 of the proposed dispatch should be appropriately reworded in keeping with the
25X1 opinion of this office dated 10 December 1953, subject,"Annual Leave, [redacted] Staff Agents," copies of which were furnished you.

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[redacted]
Office of General Counsel

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